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C O N F I D E N T I A L SECTION 01 OF 02 ZAGREB 000091

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SUBJECT: AMBASSADOR'S MEETING WITH CROATIAN NATIONAL OIL
AND GAS COMPANY CHAIRMAN

Classified By: Econ Officer Nicholas Berliner for reasons 1.4 b/d.

¶1. (C) Summary: In a February 5 meeting with Ambassador, Tomislav Dragicevic, chairman of Croatian national oil company INA, said that Croatia had decided not to seek additional gas imports from Russia, but would instead try to secure gas from North Africa via Italy. Dragicevic expressed disappointment that the GOC had not made more progress on the Adriatic LNG terminal during its previous term in office, but was optimistic that favorable political and market conditions would now enable the project to move forward. Ambassador stressed the need for diversity of supply, reminding Dragicevic that LNG from Croatia would also help its neighbors to lessen their own dependency on Russia. Commenting on the recent Russian acquisitions in Serbia, Dragicevic said that the Russians had clearly leveraged the current situation to their advantage with a view to Serbia's possible future in the EU and the precedent being established of Gazprom owning and operating energy infrastructure in Europe. He added, however, that if a pipeline were built into Serbia, he would advocate extending it across Croatian territory as well, as a means of collecting transit revenues. Dragicevic also discussed the OMV-MOL relationship, characterizing OMV as a formidable player that he believes will ultimately prevail in its fight for control of MOL. End Summary.

Croatia Seeking Non-Russian Gas Imports

¶2. (C) INA Chairman Tomislav Dragicevic told Ambassador Bradtke February 5 that his company was in negotiations with Italy's ENI to secure an additional 1 billion cubic meters (bcm) of gas from North Africa (Algeria). Dragicevic said INA was looking at North African gas as a means of diversifying its imports and not becoming overly-reliant on Russia. Note: Croatia currently imports approximately one-third of its natural gas (about 1.1 bcm) from Russia, producing the balance domestically. Imports via Italy would be based on swaps and make use of the Adriatic pipeline that connects INA's offshore production sites with the mainland pipeline infrastructure. Croatia desperately needs additional gas and previous talks with Gazprom never bore fruit, partly because the GOC refused to give in to Russian demands for greater access to energy projects in Croatia.

Disappointment at Lack of Progress on LNG

¶3. (C) Ambassador queried Dragicevic on the status of the LNG project planned for the Northern Adriatic, emphasizing the importance this project would have for the diversity of supply not only for Croatia, but also for Hungary, Slovenia and other countries. Dragicevic said he was disappointed that the GOC had not secured this project during the first

mandate of PM Sanader, noting ironically that INA had been talking about LNG for the last twenty years. He said time was wasted arguing over the ownership structure of the consortium for reasons related more to politics than business. However, he added that he saw no real obstacles to the project going forward now and that the high price of gas has made LNG competitive. On its current timetable, the hope is that the final investment decision and all necessary permitting could be in place by early next year (something originally expected in 2008, but delayed partially due to the Croatian elections).

South Stream and Russian Acquisitions in Serbia

14. (C) On South Stream, Dragicevic said that the project was clearly intended to thwart Nabucco. He said that, despite the enormous engineering challenges of building a gas pipeline at a depth of nearly 2,000 meters, he was convinced the Russians would build South Stream. He views South Stream and the Gazprom acquisitions in Serbia as part of a long-term Russian strategy to penetrate the European market that he is convinced Serbia will eventually join. Serbia, in Dragicevic's view, could be the precedent Gazprom has sought in Europe to own infrastructure and ultimately deliver gas to the consumer. He noted, however, that were such a pipeline actually to be built, he would advocate extending its onward route through Croatia as a means of securing transit revenues and a seat at the table in a major energy project.

OMV-MOL Relationship

15. (C) On the subject of OMV's takeover bid for MOL (Note: MOL owns 25 percent plus one share of INA), Dragicevic said "nobody can stop OMV." He said that its ownership structure in which the Austrian government's interest is in a holding

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enables OMV to act independently and free of government interference (something Dragicevic can only dream of in Croatia where the government still sets energy prices). He expects that OMV will eventually prevail in its bid for MOL. However, he does not believe that this would affect INA significantly, as its shareholder agreement with MOL limits the influence of the minority partner.

Comment

16. (C) INA's decision not to seek additional Russian gas is a positive step for Croatia's energy policy. The GOC is generally skeptical of Russian business interests and many in Zagreb view recent Russian investments in the region as a cause for some concern. At the end of the day, however, as Dragicevic's comments reveal, Croatia is also unlikely to stand idly by if the opportunity to profit from a Russian pipeline project should present itself.

BRADTKE